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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

NO. 76-1675

The North Carolina Utilities Commission, Southeastern Association of Regulatory Utility Commissioners,

Petitioners,

v.

The Federal Communications Commission and the United States of America, et al.,

Respondents.

PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners, The North Carolina Utilities Commission ("NCUC") and the Southeastern Association of Regulatory Utility Commissioners ("SEARUC"), request this Court to issue a writ of certiorari to review the judgment of the Court of Appeals for the Fourth Circuit in this case.

Opinions Below

The decision of the Court of Appeals is reported at ——F.2d——, and appears at Appendix A of the

companion volume of appendices.[1] The decision affirmed the following orders and opinions of the Federal Communications Commission ("FCC"): The FCC's First Report and Order, 56 F.C.C.2d 593 (1975), appearing at Appendix B; the FCC's Second Report and Order, 58 F.C.C.2d 736 (1976), appearing at Appendix C; the FCC's Memorandum Opinion and Order released February 13, 1976, 57 F.C.C.2d 1216, appearing at Appendix D; the FCC's Memorandum Opinion and Order released March 15, 1976, 58 F.C.C.2d 716, appearing at Appendix E; and the FCC's Memorandum Opinion and Order released April 28, 1976, 59 F.C.C.2d 83, appearing at Appendix F.

Jurisdiction

The judgment of the United States Court of Appeals for the Fourth Circuit, appearing at Appendix G, was entered on March 27, 1977. This Court has jurisdiction under 28 U.S.C. § 1254(1).

Questions Presented

(1) Did the FCC exceed its authority under Sections 2(b) and 221(b) of the Communications Act of 1934, by establishing a massive new federal registration program for terminal equipment, thereby preempting the jurisdiction of State regulatory commissions over such terminal equipment which is used predominantly for, or in connection with, local and intra-

1. Citations herein to the appendices are to pages of a separately bound companion volume to the Petition for Writ of Certiorari filed by the American Telephone and Telegraph Company, No. ____, and cited as "Pet. App."

state communication service, and which has been regulated by State regulatory commissions for over four decades?

(2) Does the FCC's registration program amount to an illegal nullification of State regulatory commissions' ratemaking powers with respect to facilities used for, or in connection with, local and intrastate communication services?

Statutes Involved

Sections 2(b)(1) and 221(b) of the Communications Act of 1934 provide as follows:

Section 2, 47 U.S.C. § 152, provides:

* * * *

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, ...

Section 221, 47 U.S.C. § 221, provides in part:

* * * *

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connec-

> tion with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local government authority.

Other pertinent provisions of that Act are set forth in Appendix H.

Statement of the Case

The North Carolina Utilities Commission ("NCUC") is a commission created by the State of North Carolina and charged by North Carolina law with the responsibility, *inter alia*, to assure the establishment and maintenance of telephone communications service within that State and to regulate the companies providing such service as common carrier public utilities. N.C. Gen. Stats., Ch. 62, §§ 3(23)(a) (6), 30, 32 (1965). The Southeastern Association of Regulatory Utility Commissioners ("SEARUC") is an organization consisting of the regulatory commissioners of the States of Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. These regulatory commissions are charged by the laws of their respective States with responsibilities similar to those of NCUC.

Although there are differences among the various States in the method of regulation, the goal in every instance is to assure the availability of high quality telephone service at just and reasonable rates to as many citizens of the State as possible. To meet this goal, the States represented herein have delegated to

their commissions the authority to regulate both the price at which telecommunications service and equipment may be offered within the State, and the terms and conditions under which such service and equipment can be offered. State commissions, such as those represented here, have actively exercised this jurisdiction since long prior to the enactment of the Communications Act of 1934. The effectiveness of State regulation in this predominantly local and intrastate telecommunications service has resulted in a nationwide telephone communications system of unsurpassed excellence and efficiency.

The issues presented by this massive new federal registration program are neither abstract nor hypothetical — they strike at the very heart of State regulatory jurisdiction as it has existed in the area of telecommunications for over forty years. The registration orders usurp the express authority of the State commissions over "facilities" used in local and intrastate services, which authority is expressly reserved by the Communications Act of 1934. Moreover, the registration program would oust the State commissions of their jurisdiction to establish and implement policies governing the rates and charges for terminal equipment. With their ratemaking policies so impaired, the ability of State commissions to meet their statutory obligations to the citizens they serve is severely jeopardized.

Thus, the interest of the State commissions in this case is to vindicate, preserve, and protect the concept of State regulation of terminal equipment — a concept that has served this nation for over forty years, and

under which this country has developed the finest telecommunications system in the world.

A. *The Nature of the Telephone Service and Facilities at Issue.*

Telephone service in this country typically begins with a piece of "terminal equipment," provided to the subscriber by the local telephone company, and consisting ordinarily of the standard telephone handset used by virtually all residential subscribers. This terminal equipment is connected to a pair of wires (a "subscriber loop") that leads to a central office where the local telephone company maintains its switching apparatus. No matter what the ultimate destination of a subscriber's call, his messages originate in the same terminal equipment and travel over the same wires to this central switching office. From this central switching office, calls are switched either within the local exchange or to other exchanges which may be within or outside the State.

Thus, all calls over the switched telephone network make use of common terminal equipment, common lines to a central switching office, and common switching apparatus in that office. Of all calls currently transmitted over those common facilities, about 97% are local exchange or intrastate, and only about 3% are interstate long-distance. *In Re Telerent Leasing Corp.*, 45 F.C.C.2d 204, 211 (1974), *aff'd sub nom. North Carolina Utilities Comm'n. v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, ____U.S.____, 50 L.Ed.2d 631 (1976).[2]

2. These relative percentages have remained constant throughout the history of telephone service in this country. At the time the Communications Act was enacted in 1934, it was estimated that 97½% or 98% of all telephone calls were local exchange or intrastate calls. 78 Cong. Rec. 10316 (1934).

In addition to the standard telephone handset, more sophisticated and specialized terminal equipment is available to a subscriber. This equipment includes private branch exchange switchboards (PBX's) for use in larger business communications systems, automatic answering and recording machines and devices for the transmission of computerized data through the telephone network. Historically, this equipment was offered by the regulated telephone companies at additional charges. More recently, however, unregulated manufacturers have entered the terminal equipment field and offered to sell or lease their equipment to subscribers for direct connection to the switched telephone network, when such connection has been permitted by tariffs filed with State regulatory commissions.

B. *The History of State Regulation of Local and Intrastate Charges, Classifications, Practices, Services and Facilities.*

From the beginning of the telecommunications industry in this country, State commissions have regulated the charges, classifications, practices, services and facilities used "for or in connection with" local and intrastate communication service, including the terms and conditions upon which a subscriber could substitute his own equipment or attach additional devices to the terminal equipment provided by the telephone company. And from its inception, this State regulation has been premised upon the concept that regulation, rather than unrestricted competition, best serves the public interest. After the expiration of the

initial telephone patents, and prior to any regulation by the States, anyone could set up a telephone exchange and offer telephone service. The result in many towns was two or three competing telephone exchange systems, requiring subscribers to install and pay for two or more telephones side-by-side in order to be able to reach every other subscriber. Such duplicative facilities required far more investment than was necessary to create an efficient telephone network.[3]

Without regulation, the early telephone companies were also free to serve whatever locations they chose, and thus they frequently elected to serve only the most profitable segments of the geographical markets in which their lines were located. Those segments consisted of areas whose residents could afford to pay high rates for telephone service and areas that were the least costly to serve, such as the more densely populated central business districts. This pattern of unregulated competition placed outlying and rural

3. The Supreme Court of Pennsylvania accurately described the deleterious effects of this early competition in the telecommunications industry in *Perry County Telephone & Telegraph Co. v. Public Serv. Comm'n.*, 108 A. 659, 661 (Pa. 1919):

> [D]uplication of facilities merely results in the placing of an additional burden upon the public by forcing patrons to maintain two systems where one would serve the purpose as effectively and at less cost . . . . The duplication of telephone systems in a given locality without connection between their lines requires subscribers to install both systems and pay for double service to reach subscribers on but one of the two systems; or, as frequently happens, subscribers maintain both systems when they can reach other users with equal facility on either system.

areas at a critical disadvantage in receiving telephone service.

The answer of the State legislatures to these problems was to substitute regulation for competition as the means of promoting the public's interest in widely available telecommunications service at reasonable prices.[4] Typically, State regulation was, and continues to be, premised on the principle that a telephone company is a common carrier public utility, and as such it is required to serve all segments of the public and to do so on fair and non-discriminatory terms. The State commissions were given power fully to regulate the price of telephone service to different groups of subscribers and to require that such service be made available to all without regard to costs of such service for particular groups of subscribers. So long as a fair overall return can be earned, it is the ultimate responsibility of the State commissions, not the telephone companies, to determine the amounts different classes of telephone users should contribute to meet the companies' overall revenue requirements.

As a corollary to regulation in the public interest, State commissions were also given the power to limit entry into the telecommunications industry. Since public interest frequently required the maintenance of rates unrelated to costs, this control over entry was absolutely critical to the regulatory scheme. Otherwise, unregulated competitors could enter those portions of

4. State regulation of telecommunications became widespread beginning in the late 1890's, and by 1910 only a few States had not enacted regulatory statutes. Today every State has an agency charged with the responsibility of regulating telecommunications within its borders.

the market in which the rates were relatively high compared to the costs and "skim the cream" of the business — a practice that would be plainly detrimental not only to the regulated telephone company, but also ultimately to the ordinary residential user for whose benefit these relatively higher rates were prescribed in order to make basic telephone service available at just and reasonable rates.

The jurisdiction thus exercised by State commissions became a powerful tool for the development and implementation of public policy. Most State commissioners recognized at an early date that business subscribers receive more value than residential subscribers from telephone service. On the basis of this value-of-service principle, business subscribers have generally been required to pay higher rates than residential customers. This permits the regulatory agencies to keep residential rates relatively lower, thereby promoting the general availability of service. *See, e.g., Re Pacific Telephone & Telegraph Co.*, 1919D P.U.R. 345, 370-71 (Ore. P.S.C. 1919).

A similar policy objective has been pursued by virtually all of the State commissions insofar as rural subscribers are concerned. Although it has been recognized that rural and lightly populated areas are much more costly to serve, regulatory agencies have required state-wide uniformity of rates for important aspects of telephone service, thus causing many urban subscribers to pay rates in excess of the costs of their service in order that rural subscribers can obtain service at rates they can afford. *See, e.g., Re Pacific Telephone & Telegraph Co.*, 1922C P.U.R. 248, 272 (Ore. P.S.C. 1922); *Re Mountain States Telephone & Telegraph Co.*, 1918F P.U.R. 415, 674 (Colo. P.S.C. 1918).

Yet another frequently used ratemaking practice has been that of requiring relatively high charges for certain terminal equipment in order to hold down other rates and charges. Thus, extension telephones have generally been priced at levels well above their costs on the theory that those using such telephones (presumably wealthier subscribers) should make a relatively larger contribution than subscribers using only main station service. *See, e.g., Morris v. New Jersey Bell Telephone Co.*, 6 P.U.R. (n.s.) 258 (N.J. P.U.C. 1934); *Re General Telephone Co. of California*, 80 P.U.R.3d 2, 74-76 (Cal. P.U.C. 1969); *Re Chesapeake & Potomac Telephone Co.*, 56 P.U.R.3d 91, 115 (Md. P.S.C. 1964) (same principle applied to decorator telephones designed to complement the decor of the rooms in which they are placed). Furthermore, many States have recognized the greater value to business of sophisticated terminal equipment such as private branch exchanges (PBX's) and key telephone systems, by establishing rates for such equipment substantially in excess of their costs, thereby lessening the burden upon basic residential subscribers. *See, e.g., General Services Administration v. New York Telephone Co.*, 63 P.U.R.3d 451, 462-63 (N.Y. P.S.C. 1965); *Public Service Comm'n. v. Mountain States Telephone & Telegraph Co.*, 1927B P.U.R. 193 (Mont. P.S.C. 1926).

The overriding State interest in all these ratemaking practices is the promotion of universal telephone service. Having struggled through a period of competition in the telecommunications industry that sharply restricted both the availability and the usefulness of telecommunications services, the State commissions developed ratemaking policies designed to make certain

that regulation would cure the basic defects that plagued the early days of the industry. This principle has been articulated by numerous State agencies. In *Re Pacific Telephone & Telegraph Co.*, 1919D P.U.R. 345 (Ore. P.S.C. 1919), for example, the Oregon Public Service Commissioner held:

> Residence service costs more for investment and but little less for operation than business, yet the rates must be much lower or service will not be taken. It is the extensive use of telephones in residence service that makes their use valuable to business .... [R]esidence service is commonly conducted at a loss made up in the charges for business use .... Any attempt to make rates proportionate to cost would result in residence charges so high that few householders would use the telephone at all ....

Id. at 370-71. *See also Southern Bell Telephone & Telegraph Co.*, 1929E P.U.R. 392, 396 (La. P.S.C. 1929); *Board of Trade v. Mountain Home Telephone Co.*, 1916C P.U.R. 688, 700 (N.Y. P.S.C. 1916); *Empire Telephone Co.*, 1915B P.U.R. 561, 564 (Ill. P.U.C. 1915).

Not all State commissions followed identical policies in structuring rate schedules. Complete uniformity in regulation among the States does not now exist, nor has it ever existed. At least one State regulatory agency has determined, for example, that the public interest within its State is best served by a limited amount of competition in providing telephone terminal equipment and has liberalized the conditions upon which

certain customer-provided terminal equipment can be connected directly to the network.[5] But this policy was necessarily based upon that State commission's assessment of the particular conditions existing in that State. Quite obviously, the need for a relatively greater contribution from business, urban and special equipment users to support reasonable residential rates for basic service will vary from State to State, depending upon the level of personal income throughout the State, the nature and extent of business activity, the pattern of population dispersion and numerous other factors.

It remains true that in most, if not all the States, reliance upon ratemaking powers and methodology is necessary to promote the broad availability of telecommunications services to the widest possible range of users, so as to override particular cost considerations that exist in various areas of the State and among various classes of users. Hence, most States, including all the States represented here, still require the maintenance of non-cost-related rate structures in order to hold down the price of basic residential service and thereby to bring such service within the economic reach of a maximum number of households, *See, e.g., Re Southwestern Bell Telephone Co.*, 95 P.U.R. (n.s.) 1, 9 (Ark. P.S.C. 1952); *Re Mutual Telephone Co.*, 76 P.U.R. (n.s.) 389, 402-03 (Hawaii P.U.C. 1948); *Re Southern Bell Telephone & Telegraph Co.*, 18 P.U.R.3d 113, 124 (Ky. P.S.C. 1957).

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5. *See Investigation . . . into the Promulgation of a General Order Providing for . . . the Interconnection of a Customer-Opinion and Order*, Case No. 9625, California P.U.C. (April 22, 1975).

C. *Recent Intrusion into State Regulation by the FCC.*

Prior to its recent *Telerent* order,[6] the Federal Communications Commission had never sought to oust the State commissions from their traditional jurisdiction over terminal equipment and related ratemaking policies, or from entry into the intrastate communications market. Historically, the only instances where the FCC exerted jurisdiction over terminal equipment involved highly specialized equipment *not* used in connection with switched telephone exchange service defined by the Communications Act of 1934.[7]

Where the FCC has in the past exercised its jurisdiction over interstate aspects of the switched telephone network, it has been careful not to infringe upon State regulation. In each case in which the FCC has considered the legality of tariff provisions governing interconnection, it has ruled only on the legality of interconnect conditions that were part of the *interstate* tariffs of telephone companies. *See, e.g., Use of Recording Devices*, 11 F.C.C. 1033 (1947); *Jordaphone Corp. v. American Telephone & Telegraph Co.*, 18 F.C.C. 644 (1954); *Hush-A-Phone Corp. v. American Telephone & Telegraph Co.*, 22 F.C.C. 112 (1957); *Carterfone*, 13 F.C.C.2d 420, *reconsid. denied*, 14 F.C.C.2d 571 (1968).

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6. *In Re Telerent Leasing Corp.*, 45 F.C.C.2d 204 (1974), *aff'd sub nom. North Carolina Utilities Comm'n. v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, ____U.S.____, 50 L.Ed.2d 631 (1976).

7. *See American Telephone & Telegraph Co.-TWX*, 38 F.C.C. 1127 (1965); *Department of Defense (DOD) v. General Telephone Co.*, 38 F.C.C.2d 803 (Rev. Bd. 1972), *aff'd*, 41 F.C.C.2d 1047 (1973), *aff'd per curiam, St. Joseph Telephone & Telegraph Co. v. FCC*, 505 F.2d 476 (D.C. Cir. 1974); *General Telephone Co.*, 13 F.C.C.2d 448 (1968), *pet'n. for reconsid. denied*, 14 F.C.C.2d 695 (1968).

Notwithstanding the limited scope of these prior FCC cases, it is upon these decisions that the FCC relies in upholding the registration orders that are the subject of this petition.

Carterfone, 13 F.C.C.2d 420, *reconsid. denied*, 14 F.C.C. 2d 571 (1968), was a complaint case against American Telephone & Telegraph Company ("AT&T") brought by the inventor of the Carterfone, a device for linking telephone subscribers and two-way radio operators. It was initiated by a complaint filed in federal district court in Texas, the only State which at the time had no regulatory commission, and was thereafter referred to the FCC. The case was not a rulemaking proceeding and did not purport to bind anyone not a party to it. It involved only the long-distance, interstate tariffs of AT&T filed with the FCC — not the local or intrastate tariffs of any of the AT&T system operating companies or the tariffs of any independent telephone company. No State or State commission was a party to the proceeding, nor did any have reason to intervene. No question of substituting customer-provided terminal equipment or equipment offered by a local telephone company was raised.[8] The decision in *Carter-*

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8. Indeed, in *Carterfone* the FCC itself rejected the very position asserted by FCC counsel in the court below. There, General Telephone Co. "contended that the Commission 'has opened the door to customer ownership of telephone handsets.'" The Commission flatly rejected this contention on the basis that, "The facts of this case did not involve the furnishing of purely telephone system equipment telephone-to-telephone on the message toll telephone system." 14 F.C.C.2d at 572.

Three months later, the FCC again rejected the same contention, noting that *Carterfone* did *not* hold that a customer

fone did not purport to restrict State commissions, nor to affect the States or their ratemaking policies in any way. Thus, no question of interfering with State juris-

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may substitute his own equipment for that furnished by the telephone company:

> We were concerned in [*Carterfone*] with the lawfulness of tariff provisions that prohibit a customer from making harmless interconnection of his terminals or systems with the message toll telephone system of the telephone companies. As we have heretofore stated, *this telephone system includes the telephone instrument* which performs the network control signalling functions for message toll telephone service. We were therefore concerned with what could be connected or attached to this telephone system. *Our decision in Carterfone does not hold that a customer may substitute his own equipment or facilities* (whether it be *telephone instruments*, loops, poles, or central office equipment) *for that furnished by the telephone company in providing message toll telephone service* as that service is defined in the tariff. Our decision dealt with interconnections and not replacements of any part of the telephone system. We emphasized this in our decision where we stated that "our conclusion here is that a customer desiring to use an interconnecting device to improve the utility to him of both the telephone system and a private radio system should be able to do so, so long as the interconnection does not adversely affect the telephone company's operation or the telephone system's utility to others." 13 F.C.C.2d at page 424. In denying petitions for reconsideration we again made this clear by stating that "General has contended that the Commission has opened the door to customer ownership of telephone handsets. The facts of this case did not involve the furnishing of purely telephone system equipment telephone-to-telephone on the *message toll telephone system*." 14 F.C.C.2d 571 at page 572.

AT&T, 15 F.C.C.2d 605, 609-10 (1968) (emphasis supplied).

diction over local and intrastate service or rate policies was present.[9]

When *Carterfone* was decided by the FCC in 1968, the State commissions thus had every reason to assume that their jurisdictions were not threatened, since the decision involved only interstate rates and tariffs. The FCC itself made this assumption; for, at virtually the same time it was deciding *Carterfone*, it also ruled in another proceeding that the FCC could not regulate the telephone handset or other terminal equipment "merely because of the circumstance that every telephone can be connected with a toll line for interstate calls." *General Telephone Co.*, 14 F.C.C.2d 695 (1968). According to the Commission in that proceeding:

> When the Communications Act was enacted in 1934, Congress was concerned that the telephone might be considered an instrumentality of interstate communication merely because of the circumstance that every telephone can be connected with a toll line for interstate calls. Since the interstate calls of the independent telephone companies were such a small part of their business as to be merely incidental, *Congress agreed with the* [United States Independent Telephone Association]

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9. *Hush-A-Phone Corp. v. American Telephone & Telegraph Co.*, 22 F.C.C. 112 (1957), was likewise a complaint case against AT&T and also involved only an AT&T interstate tariff filed with the FCC. Again, no local operating companies were involved, and no States or State commissions were parties. The hush-a-phone was an attachment for a telephone intended to insure privacy. No question of substituting customer-provided terminal equipment was presented.

> *position that "the tail should not wag the dog"; that their telephone facilities should remain under State regulation*, primarily because they were essentially local but also to avoid an unnecessary burden to the Commission and the small independent companies . . . .

General Telephone Co., 14 F.C.C.2d at 696 (emphasis supplied).[10]

Thus, the decision in *Carterfone*, 13 F.C.C.2d 420, *reconsid. denied*, 14 F.C.C.2d 571 (1968), for from being the watershed opinion it is hailed to be by the FCC, in fact extended only to interstate services and tariffs. It had no impact whatsoever on the ability of the State commissions to maintain their own rate policies regarding facilities used "for or in connection with intrastate exchange service . . . ." Communications Act of 1934, § 2(b) (1) (47 U.S.C. § 152).

After the *Carterfone* decision, telephone companies in interstate communications filed with the FCC amended tariffs changing restrictions on the connec-

10. The FCC Chairman reaffirmed this position in 1973 in a letter to the Chairman of a Senate Subcommittee:

> We . . . lack primary juisdiction over telephone sets which are a primary part of the facilities used in providing exchange telephone service. As you know, the Communications Act specifically excludes the Federal Communications Commission from any authority with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate and exchange telephone services of any telephone company; such local service matters are subject to the regulatory authority of State commissions in the various states.

119 Cong. Rec. S17297 (daily ed. Sept. 22, 1973).

tion of customer-provided terminal equipment to provide that interconnection would henceforth be permitted subject to two requirements designed to safeguard the telephone network: (1) that any network-controlled signalling unit must be furnished, installed and maintained by the telephone company; and (2) that no subscriber could connect terminal equipment directly to the telephone network without the use of a protective interface device supplied by the telephone company. The telephone companies filed similar revised tariffs with the regulatory commissions of the States in which the companies provided intrastate and local exchange service.

Noting an increasing use of customer-provided terminal equipment following the *Carterfone* decision, the North Carolina Utilities Commission instituted an investigation into the effects of interconnection on several broad areas of public interest, including the quality, pricing, and availability of telephone service in North Carolina.[11] Following the submission of studies and data relating to the issues, the North Carolina Utilities Commission issued an order on June 29, 1973, which gave notice of a proposed rule under which no telephone company doing business in North Carolina would be permitted to provide service over its communications system "except through station apparatus and equipment installed, owned, and serviced by the telephone company and for which the telephone company takes complete responsibility to its custom-

11. *In Re Investigation of Interconnection of Subscriber-Provided Equipment with the Telephone Network of Telephone Companies Under the Jurisdiction of the North Carolina Utilities Commission*, Docket No. P-100, Sub. 31.

er." North Carolina Order, June 29, 1973 (Rule 9-5).

On August 8, 1973, following the North Carolina Utilities Commission's announcement of its proposed rule, Telerent Leasing Corporation, an unregulated equipment manufacturer, along with a manufacturer's trade association and other equipment suppliers, filed a petition with the FCC for an order and declaratory ruling. This petition requested that the FCC rule that its regulation of interstate interconnection had preempted State regulation of interconnection with the local exchange and intrastate telephone systems. This declaratory relief was granted by the Commission on January 31, 1974 (released February 5, 1974). *In Re Telerent Leasing Corp.*, 45 F.C.C.2d 204 (1974) (hereinafter "*Telerent*"). In *Telerent* the FCC declard that its regulation of the technical standards for interconnecting terminal equipment used for interstate communications had preempted the States' long-held authority to control the interconnection of customer-provided terminal equipment in intrastate and local exchange telephone systems. 45 F.C.C.2d at 204.

The Court of Appeals for the Fourth Circuit affirmed the FCC's preemption order by a two-to-one vote. *North Carolina Utilities Comm'n. v. FCC*, 537 F.2d 787 (1976), *cert. denied*, ___U.S.___, 50 L.Ed.2d 631 (1976) (hereinafter "*North Carolina I*"). The majority opinion adopted a construction of Section 2(b) of the Communications Act of 1934 which would fragment jurisdiction over "charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communications service". The court construed Section 2(b) of the Act as authorizing the FCC to regulate "facilities" used in local and intrastate service, but not the "charges" or rates ap-

plicable to such service. The majority held that the FCC had jurisdiction over interstate facilities — including the power "to determine what terminal equipment can safely and advantageously be interconnected with the interstate communications network and how this shall be done." *North Carolina I*, *supra*, 537 F.2d at 793. Since the same facilities were used for both interstate and intrastate calls (through only approximately 3% were used for interstate calls), the court reasoned that the federal and state regulatory rules for these same facilities might conflict. Thus, it held that under Section 2(b) of the Act, the federal rule — that of the FCC — preempted the rules of the States.

The court in *North Carolina I* also held, however, that under Section 2(b) of the Act the States could continue to regulate local and intrastate telephone rates. *North Carolina I*, *supra*, 537 F.2d at 793. It based this analysis upon the legislative history of Section 2(b), which shows that in 1934 the States' concern about the possible expansion of power on the part of the new FCC "focus[ed] upon the desire of state authorities to regulate local telephone rates and charges." *Id.* The majority reasoned that paramount federal jurisdiction over facilities would not interfere with State jurisdiction over rates since "ratemaking typifies those activities of the telephone industry which lend themselves to practical separation of the local from the interstate . . . ." *Id.* Accordingly, the majority found that extending FCC jurisdiction to local "facilities" would not result in encroachment upon State jurisdiction over "charges" or rulemaking powers. On this basis, it noted that its decision was consistent with the legislative history of the Communications Act of 1934 which showed plainly that the States were intended to have exclusive

jurisdiction over local telephone rates and charges including the rates and charges for terminal equipment.

D. *The Registration Orders and the Decision of the Court Below.*

This Court declined to review the FCC's decision in *Telerent*, which was affirmed by the United States Court of Appeals for the Fourth Circuit in *North Carolina I* ___U.S.___, 50 L.Ed.2d 631 (1976). The FCC in *Telerent* granted declaratory relief preempting the jurisdiction of NCUC because whatever regulations the FCC might ultimately adopt with respect to terminal equipment might be inconsistent with the exercise by NCUC of its jurisdiction. By contrast the FCC has now exercised its asserted jurisdiction by promulgating a series of orders which established a massive new federal regulatory program permitting direct interconnection of customer-provided terminal equipment to the local telephone company exchange facilities.

(1) *The FCC's Registration Orders.*

On November 7, 1975, the FCC released its first report and order in Docket No. 19528, which provided for registration of all types of terminal equipment, with the exception of certain specific categories such as PBX's, key telephone systems and main station telephones. 56 F.C.C.2d 626 (1975) (Pet. App. 1b). Shortly thereafter, even these three categories of equipment were made subject to the registration program by the issuance of the FCC's second report and order. 58 F.C.C.2d 736 (1976) (Pet. App. 1c).

Under the registration program promulgated by

the FCC, any piece of customer-provided terminal equipment meeting certain technical requirements and "registered" with the FCC may be directly connected to the local telephone company exchange facilities without the use of a protective interface device or of a network control signalling unit furnished and maintained by the telephone company. (Pet. App. 12b). All current tariffs inconsistent with these registration orders, including tariffs on file with the State commissions covering local or intrastate service, were invalidated:

> Except as herein provided, carriers may not require the use of such connecting arrangements or other interface devices or arrangements for FCC registered equipment or protective circuitry, and *may not impose other tariff conditions contrary to the Carterfone policy* without prior approval of the Commission.

56 F.C.C.2d at 599 (emphasis supplied).

The FCC, under the registration orders, would exercise no regulatory jurisdiction over the price to be paid by the subscriber for this terminal equipment. However, by invalidating tariff conditions contrary to the *Carterfone* policy, the registration orders would deprive the States of the power to compel compliance with their own ratemaking policies. In this respect, the registration orders inject an entirely new dimension into the controversy between the FCC and the State regulatory commissions over the interconnection of facilities. *North Carolina I* involved the validity of an FCC declaratory ruling by which the FCC sought to bar a State rulemaking proceeding. By contrast, in promulgating its registration orders the FCC has

moved far beyond an abstract declaration of jurisdiction. These orders promulgate a sweeping federal regulatory program that dictates the terms and conditions upon which customer and carrier supplied equipment may be connected to the telephone network. The registration orders now assert the FCC's power not only to preempt State jurisdiction over the technical standards for interconnection of facilities to the nationwide telephone network, but also to effectively nullify the States' ratemaking powers with respect to the use of those facilities.

In spite of the obvious impact on State ratemaking policies, the FCC declined to consider the economic impact of increased interconnection prior to its adoption of the registration program. (Pet. App 14b). The State commissions, however, whose constituents stand to lose the most from any adverse economic impact on State ratemaking policies, have continued to be concerned with the economic consequences. One of the primary purposes of the North Carolina Utilities Commission proceeding (which resulted in the FCC's *Telerent* order) was "to investigate the economic and service impact that interconnection is or will have in North Carolina and what change, if any, should be made in the method of providing telephone service and establishing telephone rates." North Carolina Order of Investigation, dated February 2, 1973, at page 12. A study conducted by the National Association of Regulatory Utility Commissioners ("NARUC") concluded that wide-spread connection of customer-provided terminal equipment could result in increased telephone rates for local residential and other users of approximately $360-740 million annually by 1980,

and approximately $1 billion by 1984. *NARUC Report after Investigation*, May, 1974.

The FCC's own inquiry into the economic impact of interconnection has been limited, and after the fact. After its decision in *Telerent*, the FCC established Docket No. 20003, as a separate inquiry into the economic impact, *inter alia*, of interconnection. However, the FCC decided to implement its massive registration program before it concluded the proceeding that was to gauge the expected economic impact of that program.[12] Moreover, Docket No. 20003 was designed to consider *federal* ratemaking policies. It does not even purport to deal with the destructive impact of interconnection on *State* ratemaking policies, which is the abiding concern of the State commissions herein.

(2) *The Decision of the Court of Appeals*

The registration orders were affirmed by the Court of Appeals for the Fourth Circuit on March 22, 1977, in an opinion issued over a vigorous dissent. (Pet. App. 1a). Prior to reviewing the registration orders, the Court of Appeals stayed the implementation of the registration program, recognizing that "the cost of changing the rating structure is irretrievable and must be paid by the subscribers." (Pet. App. 1j). Subsequent to its decision, the court stayed issuance of its mandate pending petitions for certiorari. (Pet. App. 13j).

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12. After this case had been briefed and argued in the court below, the FCC issued a first report (with no order) in Docket No. 20003. Although the court below was apprised of this first report, the majority specifically declined to rely on it in its opinion. (See Pet. App. 10a).

In affirming the registration orders, the majority held that the FCC has jurisdiction over facilities used predominately in local or intrastate service, despite Sections 2(b)(1) and 221(b) of the Communications Act of 1934. The majority so ruled even though State ratemaking policies would be nullified by the FCC's registration orders and even though ratemaking jurisdiction was expressly preserved for the State commissions under the holding in *North Carolina I*.

For these and other defects, the decision of the Court of Appeals should be reviewed by this Court.

Reasons for Granting the Writ of Certiorari

I.

The Court Below Erred in Holding that Section 2(b) of the Communications Act of 1934 Does Not Protect the Jurisdiction of the State Commissions Over Facilities Used for Local and Intrastate Communications Service.

In Section 2(a) of the Communications Act of 1934, Congress authorized the FCC to regulate "interstate and foreign communication." 47 U.S.C. § 152(a). This grant of jurisdiction is qualified, however, by a reservation of jurisdiction to the States, which is found in Section 2(b) of the Act, providing that the FCC may not use its jurisdiction over interstate communications to intrude upon the States' jurisdiction over intrastate communications, charges, services or facilities:

> Subject to the provisions of Section 301 of this Title [dealing with radio frequencies and not applicable to this case], nothing in the chapter shall be construed to apply or to give the Commission

> jurisdiction with respect to (1) charges, classifications, practices, services, *facilities*, or regulations *for or in connection with intrastate communication service* by wire or radio of any carrier, ...

47 U.S.C. § 152(b) (empasis supplied).

In Section 221(b) of the Act, Congress also expressly reserved to the States the right to regulate "telephone exchange service," even though communication within a telephone exchange area may be across State lines:

> Subject to the provisions of section 301 of this title, *nothing* in this chapter *shall be construed to apply, or to give the Commission jurisdiction, with respect* to charges, classifications, practices, services, *facilities*, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State Commission or by local governmental authority.

47 U.S.C. § 221(b) (emphasis supplied).

The jurisdictional dispute between the FCC and the State commissions presented in this case arises out of the fact that the same local facilities — including the basic telephone handset — are used both for local and intrastate service and for interstate service. The majority opinion held that the FCC can regulate such local telephone facilities. (Pet. App. 16a). However, Section 2(b)(1) of the Act reserves to the States jurisdiction over "facilities" if they are used "for or in connection with intrastate communications service."

Since terminal equipment is so used (indeed, 97% of its use is local or intrastate), it is covered by the express reservation of jurisdiction in Section 2(b)(1).

There is nothing new about the question of who should be authorized to regulate the telephone handset and other terminal equipment. In 1934, just as today, the same local telephone exchanges and switching facilities, the same telephone handsets, and the same local loops connecting the telephones to the central exchanges, were all (or virtually all) used both for local or intrastate calls and for interstate calls. The question thus arose: Which level of government, the federal government or the States, should provide the regulatory rule that would govern these instruments of both local and interstate communication service. Congress knew that at that time approximately 98% of all calls were local or intrastate calls, and only approximately 2% were interstate. 78 Cong. Rec. 10316 (1934). Thus, it decided that "the tail should not wag the dog," and that State commissions should continue to regulate intrastate facilities, services and rates. To accomplish this purpose, the express provision of Section 2(b) regarding facilities was enacted.[13]

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13. Section 221(b) deals with the situation where a local telephone exchange overlaps State boundary lines and includes two or more States. The section provides that even in this situation — where what is essentially a local call happens also to be an interstate call — "nothing in this chapter shall be construed . . . to give the Commission jurisdiction with respect to charges, classifications, practices, services, facilities, or regulations . . . *in any case where such matters are subject to regulation by a State Commission or by local governmental authority*" (emphasis supplied). The majority below attached a great deal of significance to the fact that this latter italicized

In this respect, nothing has changed since 1934. Local exchanges and intrastate telephone messages still amount to approximately 97% of total messages. And Congress has not repealed Section 2(b) or amended Section 2(b) by omitting the word "facilities."

It is no historical accident that the Communications Act of 1934 contains such explicit reservation of State jurisdiction. The legislative history of the Act conclusively shows that it would never have been passed if Section 2(b) and Section 221(b) had not been added to the Act for the express purpose of preserving the jurisdiction of the State commissions over local telephone charges, services, and facilities. As shown above *(supra*, p. 7 *et seq.)*, the States historically regulated local and intrastate service, the conditions of such service, the charges and rate structures applicable to such service and the right to enter into the market for such service. In 1934 the State commissions feared that a newly-created FCC, with juris-

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languages does not appear in Section 2(b)(1). The majority contends that the absence of this language is a reproach to the State commissions' construction of Section 2(b)(1). (Pet. App. 15a). In fact, Section 221(b) supports State jurisdiction. Under Section 221(b), State regulation explicitly takes precedence over FCC regulation where a local exchange overlaps State boundaries. This only emphasizes the fact that the FCC has no jurisdiction at all over local exchanges or facilities where local exchanges do not overlap State boundaries.

It would have made no sense whatever for Congress expressly to provide that State jurisdiction takes precedence over FCC jurisdiction as to certain interstate calls (where exchanges overlap State boundaries), but leave it to the FCC's discretion to supersede State jurisdiction over exchanges (and facilities with those exchanges) where the exchanges do not overlap State boundaries.

diction over interstate communications, might use its jurisdiction to preempt State regulation over local and intrastate communications service — the same way the Interstate Commerce Commission used its powers to preempt State regulation of intrastate rail transportation. *Houston East & West Texas Ry. v. United States*, 234 U.S. 342 (1914) (the *Shreveport Rate Case*). In the *Shreveport Rate Case*, the Court upheld the ICC's jurisdiction under the Interstate Commerce Act to preempt State jurisdiction over intrastate railroad rates, which rates were found to discriminate against interstate commerce. In other cases, the ICC has assumed jurisdiction over intrastate transportation facilities. *E.g.*, *Railroad Comm'n. of Ohio v. Hocking Valley Ry.*, 12 I.C.C. 398, 404 (1907); *Train Service on Northern Pacific*, 112 I.C.C. 191, 195 (1926).

Accordingly, because of the possibility that the FCC might attempt to expand its jurisdiction to include local and intrastate charges, services and facilities (as the ICC had done), representatives of the States strenuously opposed the original version of the bill as introduced in both the House and Senate. *Hearings on S. 6 Before the Senate Committee on Interstate Commerce*, 71st Cong., 1st Sess., 2167-68 (1930). Because of this opposition, the bill was amended by the addition of Section 2(b), which provided that nothing in the Act was to be construed to give the FCC jurisdiction over local and intrastate "charges, classifications, practices, services, facilities, or regulations," with the addition of Section 2(b), the State commissions changed their position and supported the bill.[14]

14. John Benton, general solicitor of the National Association of Railroad and Utilities Commissioners, testified in favor of the amended bill as follows:

> *Nobody suggests that the Federal Government ought to attempt to displace the State regulatory agencies in the regulation of intrastate telephone business*, yet there is danger that State regulation will be seriously hampered and broken down if care be not taken in the framing of any law providing for an active Federal commission, exercising jurisdiction in the communications field.
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> • • •
>
> It is common knowledge that under the Interstate Commerce Act the power of the Interstate Commerce Commission has been so extended that State regulation of intrastate railroad rates has become little more than nominal.
>
> • • •
>
> Unless the Congress wishes to bring control of *local telephone business, which is now subject to State regulation* under the domination of the new commission, it cannot merely transfer the existing power of the Interstate Commerce Commission to this new commission. It must describe the field within which the new commission shall operate.
>
> • • •
>
> This bill has been drawn with care to safeguard State power to regulate local telephone service. It has been carefully considered by our executive and legislative committee representatives and has met their approval.

Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 135-36 (1934) (emphasis supplied).

When this representative of the State commissions testified in support of the bill because it "has been drawn with care to safeguard state power to regulate local telephone service," he was talking about what became Sections 2(b) and 221(b), which had no parallel in the Interstate Commerce Act.

As Senator Dill, Chairman of the Senate committee which favorable reported the bill, explained:

. . . [A]t the request of the State Commission

representatives, we wrote in certain provisions which are not in the Interstate Commerce Act, *to protect the State commissions* against being overridden by this Commission [the FCC], as the Interstate Commerce Commision has overridden some of the railroad State commissions.

Hearings on S. 2910 before the Senate Committee on Interstate Commerce, 73d Cong., 2d Sess. 179 (1934) (emphasis supplied).[15]

Given the legislative history of Section 2(b) and Section 221(b) and the fact that these sections were added to the Communications Act of 1934 for the express purpose of safeguarding State jurisdiction over local and intrastate services and facilities,[16] as well as

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15. The reports of both the Senate and House committees explained that Sections 2(b) and 221(b) were intended to reserve to the States "exclusive jurisdiction" over local and intrastate communications. *Senate Report No. 781*, 73d Cong., 2d Sess. 3 (1934); *House Report No. 1850*, 73d Cong., 2d Sess., 4, 7 (1934).

16. The court below recognized that Congress, in enacting the Communications Act of 1934, was dissatisfied with the effect of the *Shreveport Rate Case* doctrine on the Interstate Commerce Act. (Pet. App. 17a). But the court below erred in assuming that Congress and the States were only interested in preserving State jurisdiction over rates. The majority held that since the FCC's registration program in no way purports to prescribe charges for local service, State jurisdiction over "charges" was not impaired. (Pet. App. 19a). However, apart from the fact that Section 2(b) refers to "facilities" in the same phrase as "charges," the history of the Act shows that the States' concern and that of Congress was not limited to rates. John Benton's testimony shows a concern to protect State jurisdiction over intrastate telephone "business," and

charges, a cruel hoax would now be perpetrated on the States if the Act were to be construed as authorizing the FCC to preempt the State commissions with respect to terminal equipment interconnected to the local switched telephone network, and used for or in connection with intrastate communication service.

II.

The Court Below Erred in Holding that the FCC's Registration Program does not Nullify State Ratemaking Jurisdiction.

Unlike the FCC's orders in *Telerent* which were sustained by the Court of Appeals in *North Carolina I* (*supra*, p. 20) the FCC's orders herein go far beyond a declaratory order which preempts State jurisdiction over facilities because of possible inconsistency with as yet unformulated federal policy. The FCC has now adopted a policy and has implemented that policy by establishing a massive new federal regulatory program which not only supersedes State commission jurisdiction over terminal equipment used for local and intrastate service, but also nullifies State jurisdiction

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over local telephone "service." (*Supra*, p. 31). Senator Dill, chairman of the Senate committee which favorably reported the bill, described the bill as reserving to the States "control of intrastate telephone *traffic*," and as "safeguarding state regulation" over "intrastate telephone *business*." *Hearings on S. 2910 Before Before the Senate Committee on Interstate Commerce*, 73 Cong. 2d Sess. 179 (1934) (emphasis supplied).

Moreover, as shown herein (*infra*, p. 35 *et seq.*), the registration program in fact seriously impairs, if not nullifies, effective State regulation over *rates*. Therefore, even if the States historically had been concerned only with jurisdiction over rates, the registration orders constitute a clear abrogation of the States' authority in that area.

over rates for that service.

The opinion of the court below, and the earlier opinion of the Court of Appeals in *North Carolina I*, taken together, have fragmented jurisdiction over "charges" and "facilities" under Section 2(b) of the Communications Act of 1934. Under this fragmented structure of jurisdiction, the FCC would regulate facilities and terminal equipment used in local and intrastate service, but the State commissions would regulate charges for local and intrastate service.[17] The FCC's registration program at issue in this case is a massive federal intrusion into a highly sensitive area of federal/state regulatory relationships. The court below sustained the registration program on the premise that such fragmented jurisdiction is workable and consistent with the Act, holding that the States "remain unfettered in their discretion to set rates for all local services and facilities provided by the telephone companies." (Pet. App. 17a). According to the court below,

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17. *In Re Telerent Leasing Corp.*, 45 F.C.C.2d 204 (1974), the FCC expressly recognized that the Communications Act of 1934 preserved the exclusive jurisdiction of the States over local telephone exchange rates and charges. In its opinion and order, the Commission conceded that only the States could regulate intrastate rates:

> [T]he legislative history of the Communications Act clearly shows that in enacting Sections 2(b) and 221(b), the Congress was primarily concerned with the preservation of traditional state jurisdiction over intrastate rates and services . . . .

45 F.C.C.2d at 219. Likewise, in *North Carolina I*, the majority held that the Act left the exclusive jurisdiction over "local telephone *rates* and *charges*" with State regulatory agencies. 537 F.2d at 793, n. 6 (emphasis supplied).

"We hold that the registration program — *as a jurisdictional matter* — does not jeopardize state ratemaking prerogatives . . . ." (Pet. App. 19a) (emphasis in original).

However, as Congress explicitly understood in 1934 when it wrote Section 2(b) into the Act (protecting the jurisdiction of the States over "facilities" as well as "charges" for intrastate service), jurisdiction over local charges and facilities cannot practically be fragmented; and the State commissions must have jurisdiction over facilities and entry into the market for terminal equipment in order to preserve and effectuate State policies with respect to rates and charges.

The FCC's orders at issue in this case would impair, if not totally destroy, the power of the States to pursue their ratemaking policies, at least insofar as the rates for terminal equipment are concerned. *(Supra*, p. 23 *et seq.)*. By permitting free entry into the terminal equipment segment of the telecommunications business, the registration orders necessarily remove the vital underpinning of any effective State regulation in the public interest. No subscriber to telephone service will willingly pay rates including terminal equipment charges substantially in excess of the cost of such equipment, if the same or similar equipment is available at cost-related prices from an unregulated company. If the telephone companies were required to maintain such charges, they would unquestionably lose their terminal equipment business and, with it, the very contribution to basic service which the rate structure was designed to provide. In such a situation, a State regulatory agency could not maintain a ratemaking policy which included the support of basic

residential rates through the imposition of terminal equipment charges in excess of costs.

That such unrestricted entry by unregulated suppliers renders State regulation ineffective can hardly be questioned. This Court has expressly recognized that unregulated competition effectively undercuts regulation in any market in which it is permitted. *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329 (1951); *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n of Indiana*, 332 U.S. 507 (1947). Both of these cases involved efforts by users of natural gas to circumvent State regulation by purchasing gas directly from out-of-state producers on the theory that such interstate sales were beyond the jurisdiction of State regulatory agencies. Since such direct sales would have undercut the rate structures established for natural gas in both of these States, the State regulatory agencies involved moved forcefully to protect their rate structures.

In the *Panhandle-Indiana* case, the regulatory agency asserted State jurisdiction over the direct interstate sales. In upholding this assertion of State jurisdiction, this Court explicitly recognized that such jurisdiction was necessary for effective State regulation of intrastate sales of natural gas:

> The Natural Gas Act created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state

> regulatory agencies. It does not contemplate ineffective regulation at either level. We have emphasized repeatedly that Congress meant to create a comprehensive and effective regulatory scheme, complementary in its operation to those of the states and in no manner usurping their authority. *Public Utilities Comm'n v. Gas Co.*, 317 U.S. 456, 467; *Power Comm'n v. Hope Gas Co.*, 320 U.S. 591, 609-610; *Interstate Gas Co. v. Power Comm'n*, 331 U.S. 682, ... The scheme was one of co-operative action between federal and state agencies. It could accomplish neither that protective aim nor the comprehensive and effective dual regulation Congress had in mind, if those companies could divert at will all or the cream of their business to unregulated industrial uses.*
>
> *Over 38 percent of the gross revenues of the local Indiana utilities from the sale of gas is derived from service to the approximately 250 industrial consumers served by them. If service to any substantial number of the industrial users were to be taken over by appellant, the local utilities not only would suffer great losses in revenue, but would be unable to dispense with more than a trival percentage of their plant properties. The resultant increase in unit cost of gas would lead necessarily to increased rates for the consumers served by the local companies.

332 U.S. at 520-21.

In the *Panhandle-Michigan* case, the regulatory agency completely prohibited the contemplated interstate sales. Again this Court upheld State regulation, pointing out:

> Thus, not only would there be two utilities using local facilities to accommodate their distribution systems, but they would be seeking to serve the same industrial consumers. Appellant asserts a right to compete for the cream of the volume business without regard to the local public convenience or necessity. Were appellant successful in this venture, it would no doubt be reflected adversely in Consolidated's over-all costs of service and its rates to customers whose only source of supply is Consolidated. This clearly presents a situation of 'essentially local' concern and of vital interest to the State of Michigan.

341 U.S. at 334.

The significance of the *Panhandle* cases does not depend upon a contention that the natural gas and telecommunications industries are entirely alike (because they are not) or that the Natural Gas Act and the Communications Act of 1934 establish parallel regulatory structures (because they do not). Rather, this Court's holding in both *Panhandle* cases was predicated on a much broader principle — the principle that where Congress has created a dual regulatory scheme involving both state and federal regulating, a statute must be construed to permit *effective* regulation in their respective spheres by both the state and federal agencies. The telecommunications industry does not differ from the natural gas industry in this critical respect; sales by unregulated companies in

unrestricted competition with regulated common carriers will inevitably drive the price of terminal equipment down to cost-related levels. Such a market situation will render the State regulatory agencies' acknowledged ratemaking power ineffective, or what is worse, actually counterproductive. Any effort to regulate prices in a competitive environment can only place the regulated companies at a disadvantage *vis-a-vis* their unregulated competitors and hurt, rather than help, the regulatory agencies' efforts to achieve their public interest objectives.[18]

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18. The dependence of effective State rate regulation upon the power of State regulatory agencies to exercise traditional ratemaking powers with respect to telephone facilities was explained in testitmony before a Senate committee investigating broad aspects of the telecommunications industry by Professor Cyrus J. Colter, a member of the Illinois Commerce Commission for more than 23 years:

> At present, the state regulator is able to design rates in a way that the charge for the basic services — i.e., for the use of his telephone by the average householder — is held low, while other charges, such as for terminal facilities, extensions, PBX's, etc., are kept higher. Also, residential rates are invariably kept lower than business rates. These rate policies are not new, but historical, and have served the nation well.
>
> But now these new — and I can only call them selfish — interests have appeared with the clear intention of underpricing in those special areas in which regulators have heretofore kept the prices higher; kept them higher in order to provide lower, though reasonable, charges for the great body of household telephone users across the country. Such competition may be good for these special interest entities which are not at all averse to competing with a regulated system. But it is not good, in my opinion, for the American public, especially the part of it which is economically disadvantaged — the unfortunate.

Thus the registration program portends serious disruption of State ratemaking methodology and policies — particularly in the States represented herein. As has previously been noted (*supra*, p. 7 *et seq.*), for decades many States have pursued policies designed to further the availability of telephone service to residential users. In some States, this policy has been pursued so successfully that there are relatively few families so poor that they cannot afford to have a telephone. In such States, it may be that State regulatory commissions would consider the success of that policy in deciding whether to allow interconnection of customer-provided equipment or whether to make other adjustments in the rate structures which would have the effect of raising the rates for residential service. The State of California already appears to be moving in this direction. *See Investigation . . . into the Promulga-*

> It ties the regulator's hands as he attempts to set rates which will meet overall public interest standards — and especially the needs of the poor, the elderly, and the ill. To allow selective entry into this market by, for example, the specialized common carrier can only result in a further dislocation of present tenuous regulatory rate options. Regulators would then have no choice but to give greater weight than formerly to the cost of serving each class of customer with the result that a steeper rate of increase to the lower-income telephone user would be inescapable. Some may ask, "What's wrong with that? This customer is only being asked to pay his fair share — what it costs to serve him." What in my opinion, is wrong with it is that it lacks the input of responsible government with a social conscience — without which a government will not long be governing.
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> *Hearings on S. 1167 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 93d Cong., 2d Sess., pt. 5, at 3812-13 (1974).

tion of a General Order Providing for . . . the Interconnection of a Customer—Opinion and Order, Case No. 9625, California P.U.C. (April 22, 1975). However, in many of the States represented by SEARUC, the goal of universal service has not yet been fully achieved. In Mississippi, for example, nearly 20 percent of the households are still without any telephone service at all, and many others must rely upon shared party line service. Other States have similar problems, not only those in the predominantly rural areas of the South but also those elsewhere. Thus, whatever the policies of the richer States of the Nation, the regulatory commissions of the States represented herein should not be foreclosed from exercising their jurisdiction so as to maintain rate structures calculated to make it easier for families to afford telephone service.

Whatever else one may say about the Communications Act of 1934, in particular Sections 2(b) and 221(b) of that Act, and the legislative history of those sections, it is plain that Congress did not propose to authorize the FCC to disable the State commissions from performing their historic functions of regulating local matters, including rates. Sections 2(b) and 221(b) of the Act make it clear that Congress did not intend to supersede the State commissions in the sphere of local and intrastate rates, and that it did not intend for the FCC to exercise its regulatory authority so as to nullify State commission policies with respect to those rates.

III.

This Court Should Grant Certiorari to Vindicate Basic Principles of Federalism.

At bottom, this case does *not* present any question

as to whether competition rather than regulation with respect to terminal equipment is in the public interest. Rather, it presents the issue of which level of government — federal or state — is authorized, under the Communications Act of 1934, to decide what is in the interest of the public which uses telecommunications service.

The decision of the court below appears to have turned less on statutory language than on an unarticulated premise that any entity as large and complicated as our national telephone network somehow must be regulated in its entirety by a federal agency, rather than a multitude of State commissions. No premise could be further from the truth. Our national telephone network is, in fact, made up of hundreds of local telephone companies and exchanges, all with different markets, customer needs and service problems. In 1934 these facilities were used approximately 98% of the time for local or intrastate calls; today approximately 97% of all calls are local or intrastate. In recognition of this fact, Congress attempted in Sections 2(b) and 221(b) to preserve State regulatory jurisdiction over this predominantly local variety of service. As already pointed out (*supra*, pp.17-18), the FCC itself recently recognized that Congress in enacting the 1934 Act had properly decided that "the tail should not wag the dog." *General Telephone Co.*, 14 F.C.C. 2d 695, 696 (1968).

We have in this country telephone communications systems of unsurpassed excellence and efficiency, and we have built and maintained these systems — since the very beginnings of the industry, and certainly in the four decades since 1934 — almost exclusively under State regulation. This record of State regulation of predominantly local and intrastate telecommunications

service certainly compares favorably, to say the least, with the results of federal agency regulation of such predominantly interstate carrier services as railroad transportation and the airline industry.

The right of the States in our federal system to adopt policies reflecting local conditions and local views as to what promotes the public interest, and to experiment in implementing these policies, should be preserved. Our system of government is founded on the belief that progress will most likely be achieved, and stagnation avoided, not by a single, monolithic government or governmental rule, but by a multitude of governments — with the States and local governments free to adopt policies reflecting local conditions and local views as to what promotes the public interest. This belief has nowhere been better expressed than by Mr. Justice Brandeis, dissenting in *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932):

> There must be power in the States and the Nation to remould, through experimentation, our economic practices and institutions to meet changing social and economic needs. I cannot believe that the framers of the Fourteenth Amendment, or the States which ratified it, intended to deprive us of the power to correct the evils of technological unemployment and excess productive capacity which have attended progress in the useful arts. [Footnote omitted].
>
> To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a labora-

> tory; and try novel social and economic experiments without risk to the rest of the country.

This Court has vindicated[19] the views of Justice Brandeis and has emphasized the importance, in construing federal regulatory statutes, of protecting the regulatory powers of the State commissions. Thus, in *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945), this Court held that in enacting the Federal Power Act, Congress had preserved the power of the States to devise their own regulatory policies for dealing with local public utilities. In doing so, this Court emphasized the importance of State regulation as providing "laboratories" for testing regulatory policies:

> But state lines and boundaries cut across and subdivide what scientifically or economically viewed may be a single enterprise. Congress is acutely aware of the existence and vitality of these state governments. It sometimes is moved to respect state rights and local institutions even when some degree of efficiency of a federal plan is thereby sacrificed.
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> • • •
>
> Congress may think complete centralization of control of the electric industry likely to overtax

19. Although the *New State Ice* case has never expressly been overruled, this Court has recognized that Mr. Justice Brandeis' dissent, rather than the majority opinion, states the correct interpretation of the Due Process Clause and accurately describes the power of the States to regulate public utilities. *See Nebbia v. New York*, 291 U.S. 502 (1934); *Breard v. Alexandria*, 341 U.S. 622, 630-33 (1951); *Fay v. New York*, 332 U.S. 261, 296 (1947). *See also Johnson v. Louisiana*, 406 U.S. 356, 376 n.16 (1972) (concurring opinion of Mr. Justice Powell).

> administrative capacity of a federal commission. It may, too, think it wise to keep the hand of state regulatory bodies in this business, *for the "insulated chambers of the states" are still laboratories where many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment.*

324 U.S. at 530 (emphasis supplied).

Moreover, these cases, and many others, reflect the further principle that even where federal power exists both under the Constitution and as reflected in congressional legislation, the exercise of such power and any economic consequences, must be carefully weighed and thoroughly justified where encroachment upon the powers of the States may result. Given the broad sweep of federal constitutional powers and the generality of the language of many federal statutes, this principle is critical to the maintenance of a viable federalism. Without it, federal agencies acting under broad mandates could render the States and their governmental agencies impotent to deal with any matter remotely relating to a subject covered by federal law, even though Congress specifically intended that the States should continue to play a meaningful role with respect to that subject, and even though all proper federal responsibility could be discharged without interfering with effective State regulation. There are no findings in any of the Commission's reports in this case that remotely address this basic concern for the principles of federalism, or even undertake to gauge the potentially significant, and irretrievable economic impact of its decision.

The FCC's findings with respect to the adequacy

of its registration program to protect the nationwide telephone network do not justify the invasion of the States' ratemaking powers that result from these orders, especially where economic consequences that are certain to occur are ignored or are left to another proceeding. The mere fact that equipment has been certified as technically adequate for interconnection to the nationwide switched telephone network does not justify orders *requiring* the States to permit the interconnection of such equipment without regard for the economic consequences of such interconnection, and without regard to the effect of such interconnection upon State ratemaking policies.[20]

20. Judge Widener, in a vigorous and well-reasoned dissent from the opinion below, decried the failure of the FCC to provide any reasoned analysis or basis for embarking on such a massive and largely irreversible program:

> [W]e abdicate our responsibility as a reviewing court when we fail to insist that regulatory action, once taken, results from a process of fair, reasoned decision-making. *International Harvester Co. v. Ruckelshaus*, 478 F2d 615 (D.C. Cir. 1973); *Greater Boston Television Corp. v. FCC*, 444 F2d 841 (D.C. Cir. 1970), cert. den., 403 U.S. 923 1971). To that end, basic principles of administrative law have evolved that require such agencies as the FCC to make necessary supportive findings of fact, *Saginaw Broadcasting Co. v. FCC*, 96 F2d 554 (D.C. Cir. 1938), cert. den. 395 U.S. 613 (1938), and to "articulate with with reasonable clarity its reasons for decision, and identify the significance of crucial facts." *Greater Boston*, at 851.
>
> Here, while the grounds upon which the Commission acted are not left to our speculation, and we are advised as to the facts before the Commission when it acted, both are manifestly inadequate to support the far-reaching regulatory action taken. *Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973); *FCC v. RCA Communications, Inc.*, 346 U.S. 86 (1953); see *SEC v. Chenery Corp.*, 318 U.S. 80 (1943). The serious and thus far unrefuted claims of adverse economic effect advanced by the petitioners, the Commission's fundamental statutory obligation to oversee the provision of the communication services at reasonable charges to "all the people of the United States," and the equally basic duty of an agency to consider all pertinent public interest factors properly before it in exercising its rulemaking or adjudicatory functions, dictate that the FCC be required to conduct an inquiry into potential impact on telephone rates to the public prior to embarking on this expensive, risky, uncertain, and largely irreversible course.

(Pet. App. 37a-38a) (footnotes omitted).

The plain fact is that questions of technical standards are quite different from questions of ratemaking policy, and the FCC's reports simply do not address questions of economic impact and ratemaking policy.[21]

21. As is pointed out herein (*supra*, p. 25), the economic consequences of interconnection were not the subject of Docket No. 19528, which docket resulted in the registration orders. Rather, economic consequences were to be explored in a separate proceeding, Docket No. 20003. But even Docket No. 20003 provides no support for the registration program. First, the FCC decided that the registration orders should be implemented before it concluded Docket No. 20003. This resulted in the strange procedure whereby the regulatory cart was permitted to go before the horse. Second, Docket No. 20003 was designed to study the economic impact of interconnection on *federal* ratemaking policies. It did not purport to address the question of the disruptive impact of interconnection on State ratemaking policies; nor are those policies currently subject to re-examination in comparable State proceedings. Finally, Docket No. 20003 dealt with the broad policy and economic implications of interconnection, rather than the economic impact of the registration program itself. For this reason, the court below declined to consider either the accuracy of or the evidence supporting the first report in Docket No. 20003, which was released after argument but prior to the decision below. (Pet. App. 10a).

How is the principle of universal service to be implemented in each of the States affected by the FCC's registration orders? Will deregulation of terminal equipment and the consequent loss of contribution to basic telephone service substantially increase the rates necessary to support such basic service in any State? If so, are the people of those States in a position to absorb such rate increases without a substantial reduction in the number of households to which telephone service will be available? If not, are there alternative ratemaking policies that can be pursued by the State regulatory agencies to reduce or offset the effect of deregulating terminal equipment? If existing rate structures do not depend to a substantial extent upon contribution from terminal equipment rates and charges in any particular State, what will be the effect in that State of depriving the State regulatory agencies of the power to establish such a rate structure in the future, should it be needed to support basic service?

The FCC's reports deal neither with these nor with many other questions that are critical to an informed exercise of ratemaking powers by any regulatory agency. The FCC's reports reveal no consideration at all of the specific policies that have been developed by the various States to promote the availability of telephone service to all; nor is consideration given to the universal service mandate of Section 1 of the Communications Act of 1934, which requires the FCC to exercise its powers so as to "make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." 47 U.S.C. § 151.

The only reasoning in support of the registration program is the FCC's implicit premise that registration can be justified as furthering competition in the market for terminal equipment. Yet this Court has squarely held that competition may not be made the sole basis for a regulatory agency's action, or for its refusal to consider other factors which affect the public interest. *FCC v. RCA Communications, Inc.*, 346 U.S. 86, 91-97 (1953); *Hawaiian Telephone Co. v. FCC*, 498 F.2d 771-77 (D.C. Cir. 1974). *See also McLean Trucking Co. v. United States*, 321 U.S. 67, 78-88 (1944). Thus, the FCC simply may not conclude without further analysis, that its registration program is justified because it promotes competition in the field of terminal equipment. It should have gone beyond such simplistic reasoning and considered the adverse consequences, economic and otherwise, of its actions. Yet, because of its narrow focus on promoting competition and on avoiding technical harm to the switched telephone network, it did not engage in such analysis.

It is thus important that the basic issue of federal/state jurisdiction in this area be conclusively resolved by this Court. In the absence of such resolution, FCC efforts to undermine and preempt State jurisdiction will continue, leading to further controversy and litigation over the parameters of federal/state jurisdiction. The Communications Act of 1934 should not properly be read to permit any federal encroachment upon State ratemaking powers. But surely, even if such encroachment could be permitted in special circumstances, the Act forbids emasculation by the FCC of State ratemaking powers without any reasoned explanation of why it is being done, why it is necessary,

what economic consequences will evolve and how the States can properly discharge their responsibilities consistent with such encroachment.

Conclusion

For these reasons, the Petition for Certiorari should be granted.

Respectfully submitted,

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